Securities Arbitration Rules to be Modified to Better Ensure Fair Proceedings

Securities arbitration attorneys soon will witness what commentators are calling "critical changes" to the rules. Once the proposed "Customer Code" receives the likely SEC approval, it will replace the Code of Arbitration Procedure at the National Association of Securities Dealers (NASD), where the great majority of investors file their claims to recover investment losses.

The rule changes are designed to streamline the arbitration process and cause arbitrators to give more consistent rulings, all with an eye toward ensuring that the proceedings are fair. Let's examine the three more important proposed rules.

First, arbitrators now will have more options available to sanction parties and their representatives for failing to comply with any provision of the Customer Code or with any Orders that the arbitrators issue. These sanctions include assessing monetary penalties, precluding a party from presenting evidence, making an adverse inference; and assessing attorneys' fees.

Second, the Customer Code adds provisions for motion practice. There are two types of motions contemplated, procedural motions and "dispositive motions before a hearing on the merits." Procedural motions will include those: to change the venue of the hearing; to combine or to separate claims or arbitrations; discovery related motions; and so forth. These motions will require, like litigation matters, a description of the efforts that the movant has undertaken to resolve the matter.

The other category of motions is the dispositive motion. These types of motions are unique to arbitration because, while they seek summary judgment type relief, they normally are not supported by documents and almost never are supported by affidavits and deposition transcripts. Nonetheless, over the last few years these motions have become common. In response, the NASD has taken the position that parties have the right to a full hearing in arbitration, though recognizing that in "extraordinary circumstances", such dispositive motions may be appropriate. To discourage the unbridled use of such motions, however, arbitrators may impose sanctions on parties who file those motions in bad faith.

Third, the Customer Code codifies the NASD's "Discovery Guide", announced and explained in NASD Notice to Members 99-90. That "Discovery Guide" had given some predictability, but not certainty, to the types of documents and information to which parties in arbitration would be entitled. Pursuant to the Customer Code, within 60 calendar days of the date that the Answer to the Statement of Claim (or complaint) is due, parties must produce the required categories of documents and information (depending upon the type of claim), or explain why they cannot be produced, or object to the production. Objections not made within that required time frame are waived, unless the party had substantial justification for failing to make the objection within the required time frame. Arbitrators are empowered to impose sanctions on parties who fail to comply with discovery provisions, and who frivolously object to production.

Overall, securities arbitration attorneys should welcome these changes. The result of the changes should be a process that ensures fairness.

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